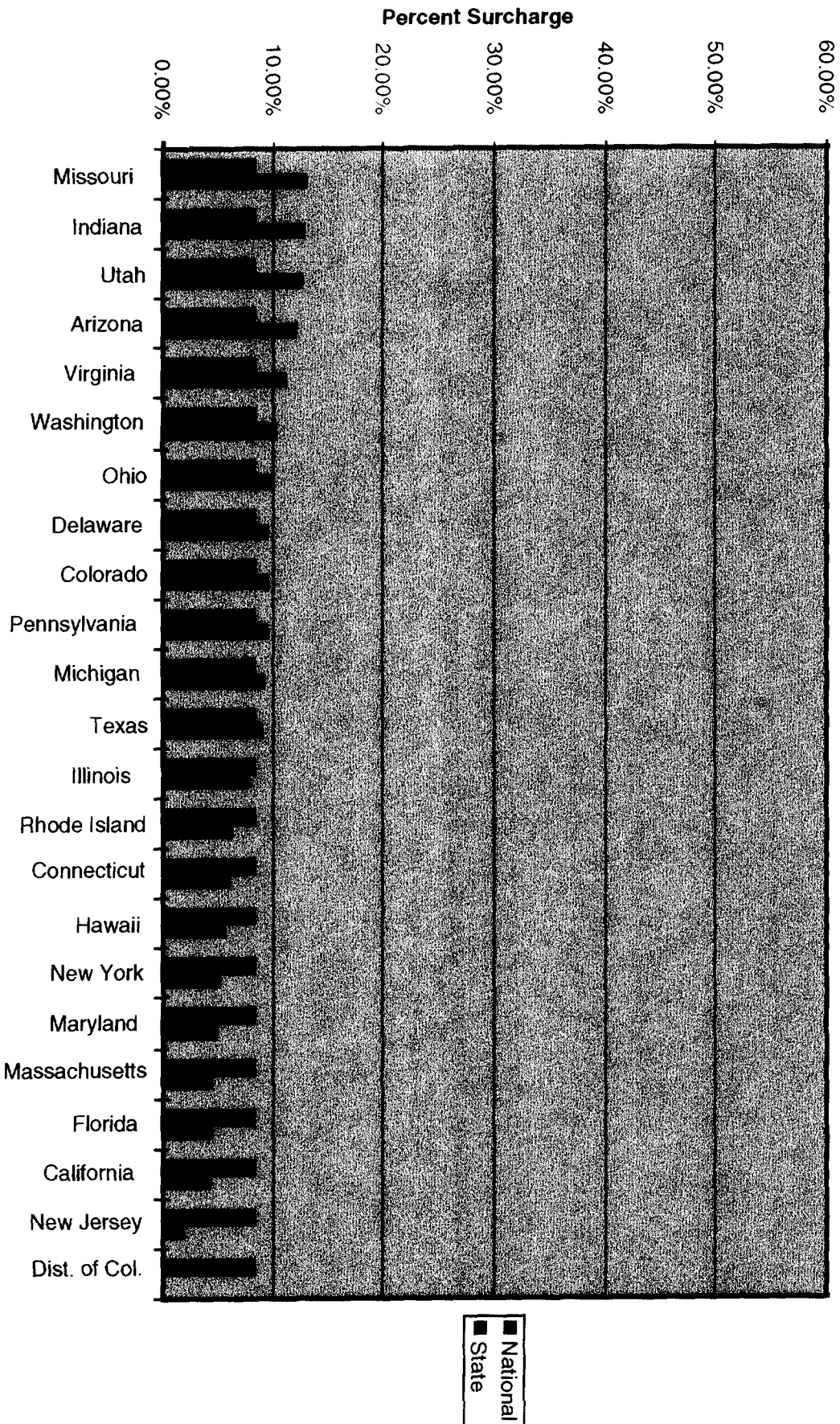


State vs. National Fund (2 of 2)

(Assumes \$13.7B Fund - BCPM @ \$30)



NOTE: Under the separate surcharges alternative, customers in all states would pay a 5.0% surcharge on all interstate services.

SUMMARY

- **BCPM IS THE APPROPRIATE MODEL FOR DESIGNING A TARGETED HIGH-COST FUND**
- **HATFIELD WAS BUILT FOR UNE PRICING, AND SYSTEMATICALLY UNDERSTATES COSTS**
- **HIGH-COST SUPPORT SHOULD BE TARGETED BELOW THE WIRE CENTER**
 - ALTERNATIVES:**
 - **CBG**
 - **ZIP CODE**
 - **“DOUGHNUT THEORY”**
 - **OTHERS**
- **THERE MUST BE A DIALOGUE AROUND THE 75/25 FUNDING STRUCTURE, AND EFFECTIVE ALTERNATIVES DEVELOPED**

FUNDING UNIVERSAL SERVICE THE 75/25 DEBATE

In the ongoing debate over implementing the universal service provisions of the 1996 Telecommunications Act, there has been confusion over the relationship between the Separations process, by which network costs are divided between the FCC and the State PUCs for regulatory and rate setting purposes, and the explicit funding process mandated by the 1996 Act to assure affordable service to all Americans, particularly those in rural high cost areas.

Ever since the landmark *Smith v. Illinois* case in the 1930s, the cost of telephone service has been assigned between the state and federal jurisdictions through the Separations process. Since there is no direct cost-causative way to separate these costs, particularly the non-traffic-sensitive costs of the local loop, the process has always been somewhat arbitrary. Initially, investment was separated based upon the relative usage of the network for intrastate and interstate services. Over the years, and in an attempt to accomplish multiple public policy objectives, state and federal regulators have employed a variety of methods to separate costs. These allocation conventions were generally named for the location where the regulators met, the last being the "Ozark" plan adopted in the late 1960's. Under Ozark, loop costs were allocated to the interstate jurisdiction by the Subscriber Line Usage (SLU) factor. When these percentage allocation factors were frozen in the early 1980's, SLUs ranged from the 40s and 50s in many of the western states to the high teens and low 20s in some eastern states.

In 1980 the FCC and the Joint Board initiated CC Docket 80-286, which remains open to this day. After first freezing SLU factors, the Joint Board decided to gradually transition allocation of loop investment to the current 75% state/25% federal factors. This meant that in some states costs were shifted to the state jurisdiction, and in others, they were shifted to the federal jurisdiction. While each state dealt with this transition in different ways, generally states which received more costs tended to place these increases on toll and access services, rather than increases in basic local rates. The FCC recently issues a further Notice of Proposed Rule Making in 80-286 to determine how the separations process should be further adjusted to account for the introduction of local competition.

In a paper *FUNDING UNIVERSAL SERVICE: NATIONAL vs. SEPARATE STATE FUNDS* we have illustrated the impact of basing the calculation of explicit funding surcharges on the same 75/25 split used for the assignment of loop costs. This paper clearly shows that for many Western, Southern and New England states, the state-specific surcharge necessary to explicitly fund universal service could, itself, raise concerns of affordability and cause other unintended consequences. In many of these states universal service is presently funded through implicit support from access charges and toll rates which will quickly erode as competition develops. Thus, we continue to believe that a funding process based on a uniform surcharge on all telecommunications services, state and interstate, best assures that the goal of affordable service for all Americans can be achieved.

U S WEST
October 1997

FUNDING UNIVERSAL SERVICE NATIONAL FUND vs. SEPARATE FUNDS

The Communications Act of 1996 requires that implicit support for universal service be removed from LEC rate structures and replaced with "specific, predictable and sufficient" explicit support mechanisms. The size of the high-cost fund which will be necessary to support affordable service in rural America has been the subject of considerable debate. The size of the necessary fund has been estimated to range from as low as \$6B to as high as \$20B. The FCC currently has an inquiry underway to develop a cost proxy model which will be used to size the fund and target support to high cost areas. In the illustration which follows, a fund size of \$13.7B is used, which is roughly half way between the two extremes¹. The results used are from the Benchmark Cost Proxy Model (BCPM) developed by BellSouth, Sprint, U S WEST and INDETEC International.

Once the size of the explicit support requirements for each state is determined, a mechanism must be developed to collect the necessary funds from all telecommunications providers on a competitively neutral basis. Two scenarios have been discussed for raising the necessary funds:

- A National fund, where the total funding requirements across all states are divided by the sum of all state and interstate revenues to compute a common surcharge for intrastate and interstate revenues.
- Separate State and Interstate funds, where 75% of the funding requirements are divided by each state's intrastate revenues to determine a state-specific intrastate surcharge, and the remaining 25% of the funding requirements are divided by total interstate revenues to develop an interstate surcharge.

The attached charts show the results of these two scenarios. This analysis shows that while a National fund would require a uniform 8% surcharge on all interstate and intrastate telecommunications services, separate State funds to recover 75% of each state's universal service costs would range from a 57% surcharge in South Dakota, to virtually zero in the District of Columbia.² For the most part, it is the western and southern states which would have the highest state-specific intrastate surcharges. Two factors interact to determine where a state falls on this continuum. The first is the number of high cost customers within a state. The second and more important factor, however, is the number of low cost customers within the state over whom the cost of supporting the high cost customers can be spread.

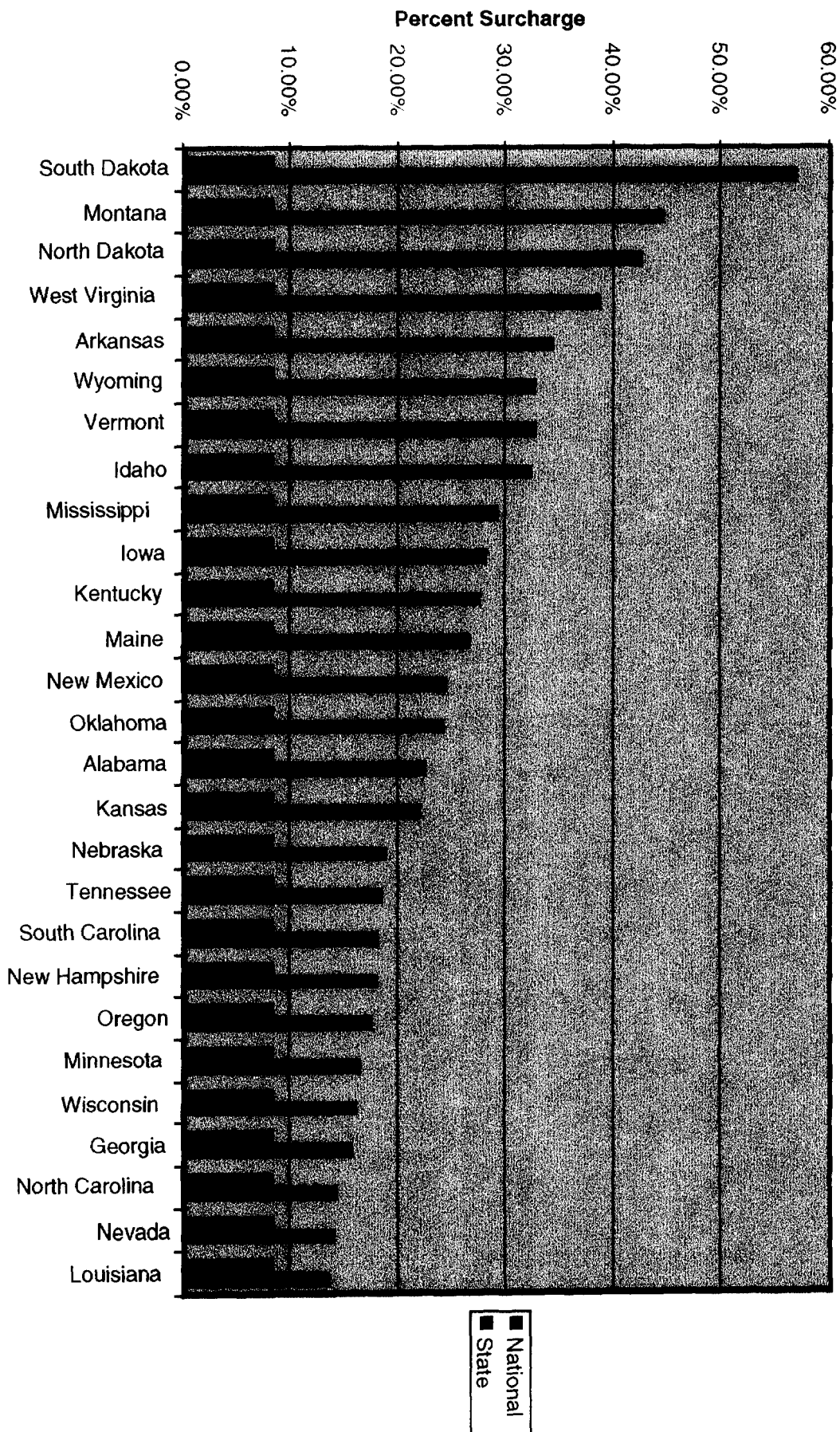
This data clearly shows why a National universal service fund will be required in order to fulfill the universal service goals of the 1996 Act. The disparity of funding assessment between states would require customers in the most costly states to pay total rates (basic rates plus surcharge) which may not meet the "affordability" standards of the Act. Furthermore, the wide disparity in assessment between the states could have unintended consequences on economic development. This is so since telecommunications is a vital element of commerce, and the disparate universal service surcharges on communications services between states could divert industries and job growth away from the rural areas which need it the most.

U S WEST
September 1997

¹ It should be noted that no matter what size of fund is ultimately determined, the relative relationship of funding requirements between states is likely to remain the same.

² In addition to the state-specific surcharge, a 5% surcharge on all interstate revenues would be required under the 75/25 scenario.

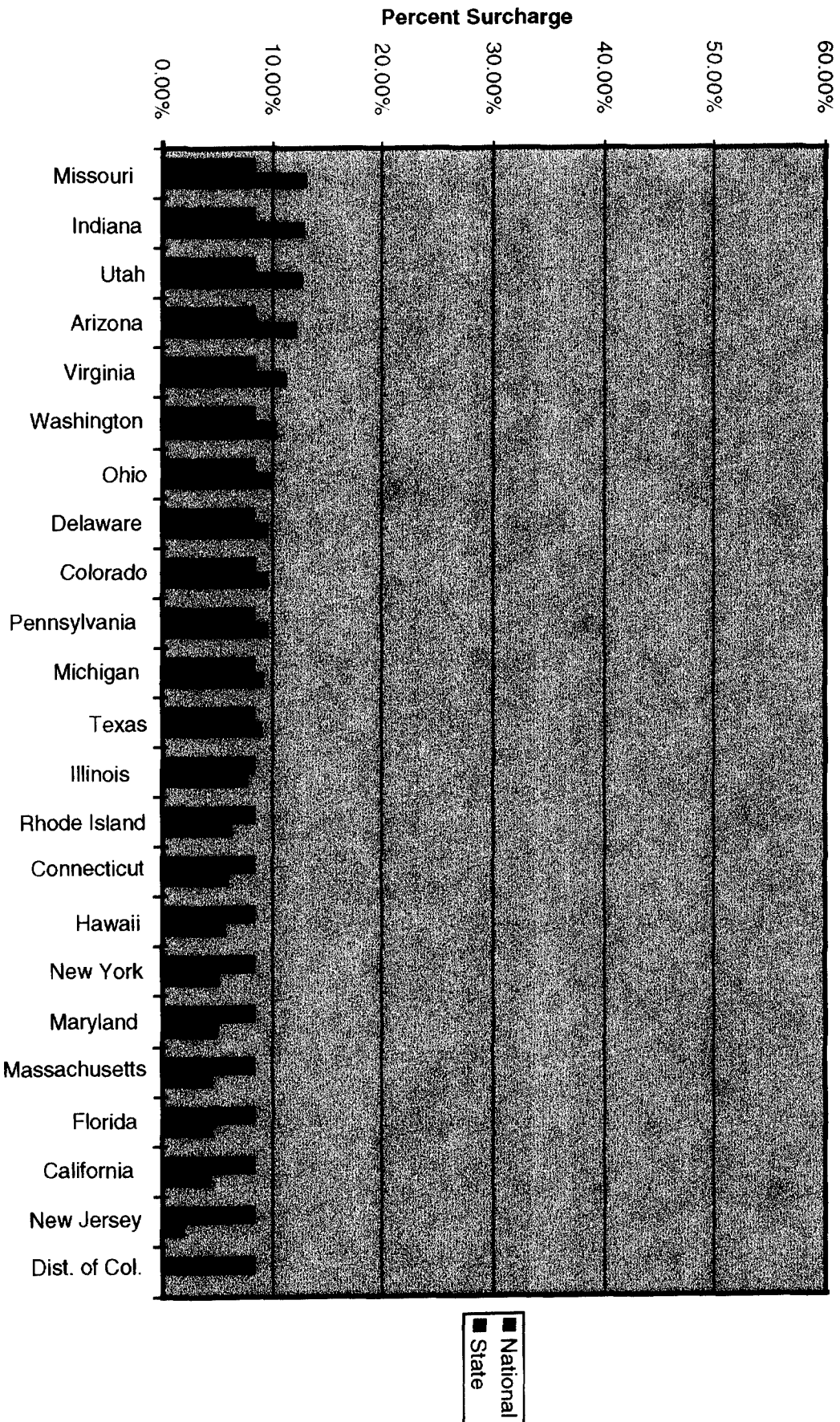
State vs. National Fund (1 of 2) (Assumes \$13.7B Fund - BCPM @ \$30)



NOTE: Under the separate surcharges alternative, customers in all states would pay a 5.0% surcharge on all interstate services.

State vs. National Fund (2 of 2)

(Assumes \$13.7B Fund - BCPM @ \$30)



NOTE: Under the separate surcharges alternative, customers in all states would pay a 5.0% surcharge on all interstate services.

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News Release

Release Date: October 22, 1997

Contact: Nanci Bernstrom
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'HOW TO USE' WORKSHOPS PLANNED FOR BCPM

Washington, D. C. -- Three 'how to use' workshops on the latest Benchmark Cost Proxy Model (BCPM) have been set for November.

The BCPM has been developed by BellSouth, INDETEC International, Sprint and U S WEST to assist regulators in determining the cost of basic telephone service, and in targeting support to high-cost areas where it will be necessary to preserve affordable universal telephone service.

Each workshop will discuss in detail how the BCPM works, how customers are located, how the model designs the network and how it determines 'forward-looking' costs. Enhancements from prior versions of BCPM also will be discussed, as well as differences from other competing proxy models.

There is no charge for the workshops which will be held as follows:

November 6 Boston, MA at the Sheraton Hotel & Towers at Copley Place from 1 to 4 p.m. in conjunction with the National Association of Regulatory Utility Commissioners (NARUC) Convention.

Additionally, the BCPM sponsors will have a demonstration room at the NARUC meeting from November 8 - 12, and will be available to do individualized presentations of the BCPM and its results. The demonstration will be in the Brandeis room on the 3rd floor in the Marriott Hotel at Copley Place.

November 18 Denver, CO at the Denver Service Center first floor auditorium located at 1005 17th Street. During this session there will be an overview presentation from 9 a.m. - Noon, and "hands-on" demonstrations from 1 p.m. until 4 p.m.

November 20 Washington, DC at the Bellcore Offices located at 2101 "L" Street 6th floor with an overview presentation from 9 a.m. - Noon, and "hands-on" demonstrations from 1 p.m. until 4 p.m.

Registration is being accepted on-line through the BCPM web site at www.bcpm2.com, or via telephone to Melina Mills at 202 828-7449.

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